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In our previous issue we mistakenly provided the incorrect title for Colin Lunn, it should be Head of Sales and Client Relationship, Asia Pacific Alternative Fund Services, HSBC Securities Services

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Andrew Crawford met with Poh Min Lam and Nelson Chia, both ex-GIC quant analysts who established the promising new manager, Octagon Capital, in late 2004. The fund has performed particularly well since its launch and is up by an impressive 29% since its inception – and has an exciting future.

What is the history of your fund/company?

Octagon Capital, the Manager, was founded in April 2004. Octagon Pan Asia Fund, the fund, was incepted in October 2004.

What is your investment strategy?

Octagon runs a niche quant-driven equity long/short strategy, aimed at generating absolute returns, while preserving capital and controlling downside volatility. Its investment decisions are made via a technically based, systematic process. The key driver is a trend-following model that is premised on the assumption that profitable trends exist in a large and heterogeneous universe. Accordingly, the model seeks to identify the best-trending stocks to be bought and sold based on a proprietary momentum measure. This is complemented by qualitative judgment used in portfolio construction and execution. This is important given the many implementation and technical constraints in Asia, such as liquidity.

What is your investible universe/opportunity set?

The team adopts a broad definition of Asia, currently operating in 11 markets, namely Japan, Australia, Hong Kong/China, Taiwan, Korea, India, Singapore, Thailand, Malaysia, Indonesia and Philippines, across all sectors and market capitalisations, covering a total of 2000-plus stocks. As Asia continues to develop, more countries will be added to the universe as they become feasibly investible. The idea is to constantly seek to capitalise on a variety of price trends within this uniquely diverse opportunity set.

What's the background of your team?

The investment team consists of Poh Min Lam, CFA (Portfolio Manager) and Nelson Chia (Trader). They have known each other for 11 years.

I have 11 years of portfolio management experience. Prior to founding Octagon, I spent nine years in New York and Singapore, with the Government of Singapore

WHY DID YOU CHOOSE THIS APPROACH?

Philosophically, they subscribe to the following tenets:

1) Breadth – exploit breadth of opportunity set to improve risk-adjusted returns;
2) Expectations - markets are driven by investor expectations and price action is the ultimate barometer of those expectations; and
3) Asymmetry – rely on return asymmetry to generate superior performance.

Realistically, they also acknowledge that their forte is not in fundamental analysis. They cannot expect to rely on unique information and insights to generate investment decisions.

Putting the two together, it is clear that their focus is on constructing a diversified portfolio of the best stock trends identified from within a large and heterogeneous opportunity set, by leveraging on a systematic, disciplined and quantitative process.

Investment Corporation (GIC) – one of Asia's largest institutional investors, with AUM of more than US$100 billion. I was the Senior Portfolio Manager in the Quantitative Investment Unit (QIU) and was instrumental in pioneering quant equities, quant fixed income, as well as convertibles investing in GIC. As the quant arm of the firm, QIU had a multi-billion dollar portfolio mandate while acting as the quantitative advisory to the asset departments. I have extensive model development experience, having implemented systems ranging from the equities momentum model, the equity-based credit trading model to the interest rate valuation model. I was responsible for conceiving and developing the GIC fixed income and convertibles risk management systems. This was complemented by one of the most extensive portfolio experiences in the firm. I was responsible for managing portfolios ranging from enhanced equities, global convertibles, multi-strategy absolute return, long/short credit to global fixed income. I graduated as the top student, with a BSc (First Class Honors) from the School of Computer Science, National University of Singapore. My major was in computer algorithms.

Nelson has 11 years of trading experience. Prior to founding Octagon, he spent nine years in New York, London and Singapore with the GIC. He was one of firm's most experienced equity traders and has traded in most of the major global equity markets, including Pan-Asia, Australia, the US, Canada and Europe. His product experience has been equally diverse, spanning both equities and equity derivatives. He graduated with a Bachelor of Commerce (Economics and Finance) from the Curtin University of Technology in Australia.

How does the team make security selection decisions within the investible universe/opportunity set?

On a daily basis, our model scans the entire investment universe and ranks the stocks based a proprietary momentum measure, which takes into account strength of trend, quality of trend, long and short-term trend, relative trend and sector trend. The momentum scores of stocks within a particular country are combined to form an aggregate country momentum score, which will determine the directional net exposure for that country. The actual stocks selected to express that net exposure are based on their relative rankings. This process helps us constantly allocate their risk capital to the best markets and best stocks.

> In humble respect for the markets, the key to winning is by "not losing".

What is your philosophy towards managing risk?

In humble respect for the markets, the key to winning is by "not losing". Managing risk is as critical as, if not more critical than, making investment decisions. And managing risk is fundamentally different from making investment decisions. Managing risk demands a response to the questions 'what if I am wrong?', 'how do I know that I am wrong?' and 'what do I do when I am wrong?'. We feel strongly that the key is in accepting the possibility of being wrong at times, no matter how good the investment process is.

As far as risk management goes, the biggest challenge is to navigate the difficult patch, to survive the fat tails. According to Nelson, in Asia, the fat tails occur more often than one would generally expect and desire to see. Other than having a comprehensive quantitative-based risk control framework to monitor our risks on a real-time basis, he also believes, as a matter of principle, in avoiding highly illiquid situations, in avoiding concentrated bets and in adopting strict stop losses. Without a doubt, he attributes their superior risk adjusted performance to their risk discipline.

Where do you see the most investor interest for your fund coming from?

In general, investors who are looking to participate in the Asian story with controlled drawdown and downside volatility. More specifically, those investors who have an interest in diversifying against the typical fundamental and value-based manager within the Asian equity long/short space.

How receptive are investors to your fund?

Since inception, we have had considerable interest in the fund, quite likely due its uniqueness – both its background and investment process. Lately, as the final piece of the puzzle (that is, performance track record) has fallen into place, investors have begun to commit more meaningfully. The fund is currently ranked as one of the top few managers and quite possibly, the top emerging manager (with less than a two-year history) in their category based on Sharpe ratio. Funds under management have grown more than tenfold in the past year, with a strong subscription pipeline expected in the next few months.

Which strategies have been working in the current market environment?

The current market environment has been relatively friendly for our momentum strategy, though more so in some countries than others. The macro trends in Korea, Japan and India in the past year have been particularly strong and they have been able to capitalise on them substantially. Elsewhere, we have benefited from sectoral and thematic trends such energy, commodities, domestic consumption, REITS and so on.

What was your best trade in the past 12 months? And why?

Our best trade was in KS Energy, a Singapore-based oil equipment and service company: "the stock was driven to the skies on the back of record high oil prices".

What was your worst trade in the past 12 months? And why?

Our worst trade was in United Tractors, an Indonesian machinery company. We got stopped out in the position when Indonesian equities were hit hard on worries linked to record high oil prices and the resultant sharp sell-off in the Indonesian rupiah.

The macro trends in Korea, Japan and India in the past year have been particularly strong and they have been able to capitalise on them substantially.

What is your outlook for the fund for the next 12 months?

Looking ahead, the prospects for Asia appear promising. With the recent broad-based rally, our model is registering its most bullish reading since its inception. Country wise, the model is no longer pointing to any clear preference. While Korea, Japan and India continue to look good, many of the laggard markets are starting to show promise. Other than Malaysia, we are seeing a plethora of opportunities across the board. Sector-wise, the model is similarly recommending broad-based participation, with a notable exception in utilities. As always, if the trends should change, the model will guide them to respond accordingly. Overall, we expect the fund to continue to do well, both in terms of risk-adjusted performance and AUM growth.

Lead manager: CV

Education	CFA BSc Computer Science (First Class Honours) National University of Singapore
Title	Partner
Career	Senior Portfolio Manager, Government of Singapore Investment Corporation (1995-2004)

Fund: at a glance

Inception date	October 2004
Investment team	Poh Min Lam (Portfolio Manager) Nelson Chia (Trader)
CEO/Chairman	-
Strategy	Equity long/short
Assets in strategy	US$10 million
Performance	Net of all fees, 29% since inception and 20% in 2005 (22% annualised)
Offices	Singapore
Minimum investment	US$200,000
Administrator	HSBC
Prime broker	Morgan Stanley
Currency	USD
Open to investment	Yes